

# 2004 Instructions for Form FTB 3805Q

## Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations – Corporations

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 2001**, and to the California Revenue and Taxation Code (R&TC).

### What's New

For taxable years beginning on or after January 1, 2004:

- California has reinstated the Net Operating Loss (NOL) carryover deduction.
- 100% of the NOL may be carried forward for ten years.

The carryover period for an NOL incurred in years:

- beginning before January 1, 2002, have been extended for two years.
- beginning on or after January 1, 2002, and before January 1, 2003, have been extended for one year.

### General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2001. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information regarding California and federal law, please visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and select "Law and Legislation." Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

Note, the instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

For taxable years that began in 2002 and 2003, California had suspended the NOL carryover deduction. Taxpayers continued to compute and carryover an NOL during the suspension period. However, the deduction for disaster losses was not affected by the NOL suspension rules.

The general NOL carryover percentage varies. For taxable years beginning on or after:

- January 1, 2004, 100% of the NOL may be carried forward;
- January 1, 2002, and before January 1, 2004, 60% of the NOL may be carried forward; and
- January 1, 2000, and before January 1, 2002, 55% of the NOL may be carried forward.

Also, any NOL incurred in any taxable year beginning on or after January 1, 2000, may be carried forward for 10 years.

In 1998, the Franchise Tax Board (FTB) implemented the new principal business activity (PBA) code chart that is based on the North American Industry Classification System (NAICS) in the corporate tax booklets. However, the California R&TC still uses the Standard Industrial Codes (SIC) for purposes of the new business and eligible small business NOL.

### A Purpose

Use form FTB 3805Q to figure the current year NOL and to limit NOL and disaster loss carryover deductions.

**Note:** Exempt trusts should use form FTB 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations – Individuals, Estates, and Trusts.

The California NOL is figured the same way as the federal NOL, except that for California:

- An NOL may be carried over only to future years (no carrybacks are allowed); and
- The carryover period and the amount to be carried over differ from federal allowances.

Only a portion of the NOL may be eligible for carryover to future years because California has established different categories of NOL. See General Information F, Types of NOLs, for more information.

**Note:** If the corporation has a current year NOL under R&TC Section 24416.2, 24416.5, 24416.6, and 24416.7 (relating to Pierce's disease, EZ, LAMBRA, or TTA NOLs), the corporation **must elect** on its return for the taxable year in which the loss is incurred to carryover the loss either under that section or the loss under R&TC Section 24416 (relating to general NOLs). If the corporation elects to compute the NOL under R&TC Section 24416.1(c) (relating to Pierce's disease, EZ, LAMBRA, or TTA NOLs), the corporation must:

- Make the election in a statement attached to the original return; and
- Use the applicable Pierce's disease form or economic development area (EDA) form to calculate the NOL.

The election is irrevocable. Get form FTB 3805D, form FTB 3805Z, form FTB 3807, or form FTB 3809 for more information.

### B Apportioning Corporations

The loss carryover for a corporation that apportions income is the amount of the corporation's loss, if any, after adding income or loss apportioned to California with income or loss allocable to California under Chapter 17 of the Corporation Tax Law. The

loss carryover may be deducted from income of that corporation apportioned and allocable to California in subsequent years.

### C Combined Reporting

Corporations that are members of a unitary group filing a single return must use intrastate apportionment, separately computing the loss carryover for each corporation in the group using its individual apportionment factors (R&TC Section 25108). Complete a separate form FTB 3805Q for **each** taxpayer included in the combined report. Attach the separate forms for each taxpayer member **behind** the combined form FTB 3805Q for all members.

Unlike the loss treatment for a federal consolidated return, a California loss carryover for one member in a combined report may not be applied to the income of another member included in the combined report. Get FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report, for more information.

### D Water's-Edge

For Water's-Edge taxpayers, R&TC Section 24416(c) imposes a limitation on the NOL deduction if the NOL is generated during a non-Water's-Edge tax year. The NOL carryover is limited to the lesser amount as re-determined by computing the income and factors of the original worldwide combined reporting group as if the Water's-Edge election had been in force for the year of the loss. If R&TC Section 24416(c) applies; the NOL carryover for each corporation may be decreased, but not increased.

### E S Corporations

An S corporation is allowed to carry over a loss that is incurred during a year in which it has in effect a valid election to be treated as an S corporation. The loss is also separately calculated under the pass-through rules and passed to the shareholders in the year incurred and is taken into account in determining each shareholder's NOL carryover, if any.

If a corporation changes from a C corporation to an S corporation, the loss incurred while the corporation was a C corporation may not be applied to offset income subject to the 1.5% tax imposed on an S corporation. However, losses incurred while the corporation was a C corporation may be applied against the built-in gains which are subject to tax. If the corporation incurred losses while it was a C corporation and an S corporation, and the S corporation is using C corporation losses to offset its built-in gains, the corporation must complete two forms FTB 3805Q and attach them to Form 100S, California

S Corporation Franchise or Income Tax Return. The unused losses incurred while the corporation was a C corporation are "unavailable" except as provided for above unless and

until the S corporation reverts back to a C corporation or the carryover period expires. However, if an S corporation changes to a C corporation, any S corporation NOLs are lost.

## F Types of NOLs

The table below shows the types of NOLs available, a description, and the percentages and carryover periods for each type of loss.

**\*Note:** For NOL carryovers suspended during 2002 and 2003 tax year, the carryover period is extended by two years for losses incurred before January 1, 2002, and by one year for losses incurred after January 1, 2002, and before January 1, 2003.

Type of NOL and Description	Taxable Year NOL Incurred	NOL Carried Over	Carryover* Period
<b>General NOL (GEN)</b> Available as a result of a loss incurred in years after 1986 and allowed under R&TC Section 24416. Does not include losses incurred from activities that qualify as a new business, an eligible small business, EZ, LARZ, LAMBRA, TTA, disaster loss, or Pierce's disease.	On or after 01/01/2004 2002-2003 2000-2001 1997-1999 1987-1996	100% 60% 55% 50% None	10 Years 10 Years 10 Years 5 Years Expired
<b>Disaster Losses (DIS)</b> Casualty losses in areas of California declared by the President of the United States or the Governor of California to be in a state of disaster. An election may be made under IRC Section 165(i) permitting the disaster loss to be taken against the previous year's income. If you made this election, see current year NOLs, Part II, line 3 and federal Form 4684 instructions for when the election must be filed. If special legislation is enacted under R&TC Section 24347.5 and the specified disaster loss exceeds income in the year it is claimed, 100% of the excess may be carried over for up to five taxable years. If any excess loss remains after the five-year period, 50% of that remaining loss may be carried over for up to 10 additional taxable years for losses occurred in any taxable year beginning before January 1, 2000; 55% for losses incurred in any taxable year beginning on or after January 1, 2000, and before January 1, 2002; 60% for losses incurred in any taxable year beginning on or after January 1, 2002, and before January 1, 2004; or 100% for losses incurred in any taxable year beginning on or after January 1, 2004.	See "List of events that declared as disasters on next page."	100%  See instructions	First 5 Years  10 Years Thereafter
<b>New Business NOL (NB)</b> Get FTB Legal Ruling 96-5 for more information. Incurred by a trade or business that first commenced in California on or after January 1, 1994, during the first three years of business, 100% of an NOL may be carried over for 10 years, but only to the extent of the net loss from the new business. The term "new business" also includes any taxpayer engaged in biopharmaceutical activities or other biotechnology activities described in Codes 2833 to 2836 of the SIC Manual. It also includes any taxpayer that has not received regulatory approval for any product from the United States Food and Drug Administration. See R&TC Section 24416(g)(7)(A) for more information. If a taxpayer's NOL exceeds the net loss from the new business, the excess may be carried over as a general NOL. If a taxpayer acquires assets of an existing trade or business which is doing business in California, the trade or business conducted by the taxpayer or related person is not a new business if the fair market value (FMV) of the acquired assets exceeds 20% of the FMV of the total assets of the trade or business conducted by the taxpayer or any related person. To determine whether the acquired assets exceed 20% of the total assets, include only the assets that continue to be used in the same trade or business activity as were used immediately prior to the acquisition. For this purpose, the same trade or business activity means the same division classification listed in the SIC Manual. If a taxpayer or related person has been engaged in a trade or business in California within the preceding 36 months and then starts an additional trade or business in California, the additional trade or business qualifies as a new business only if the activity is classified under a different division classification of the SIC Manual. Business activities conducted by the taxpayer or related persons wholly outside California are disregarded in determining whether the trade or business conducted within California is a new business. Related persons are defined in IRC Sections 267 or 318.	On or after 01/01/2000     Before 01/01/2000  Year of business  Year 1 Year 2 Year 3	100% For the first three years of business     100% 100% 100%	10 Years     8 Years 7 Years 6 Years
<b>Eligible Small Business (ESB)</b> Get Legal Ruling 96-5 for more information. Incurred in a trade or business activity that has gross receipts, less returns and allowances, of less than \$1 million during the taxable year. 100% of an NOL may be carried over, but only to the extent of the net loss from the eligible small business. If a taxpayer's NOL exceeds the net loss from an eligible small business, the excess may be carried over as a general NOL. The corporation should use the same SIC Code division classifications described in the new business NOL section to determine what constitutes a trade or business activity.	On or after 01/01/2000  On or after 01/01/1994 and before 01/01/2000	100%  100%	10 Years  5 Years
<b>Title 11 Bankruptcy (T11)</b> If the corporation is claiming an NOL carryover deduction under the provisions of R&TC Section 24416(e)(4)(A), enter the carryover amount on Part II, line 2.	1987-1993	50%	10 Years

## Specific Line Instructions

### Part I

Use Part I of this form to figure the current year NOL eligible for carryover.

**Line 2** – If the corporation incurred a disaster loss during 2004, enter the amount of the loss on this line. Enter as a positive number.

**Line 3** – If the amount is zero or less, the corporation does not have a current year general NOL. Go to Part II for computation of general NOL carryovers, the current year disaster loss, and carryover from disaster losses.

**Line 6** – Go to Part II, Current Year NOLs, to record your 2004 NOL carryover to 2005. Complete columns (b), (c), (d), and (h) only, for each type of loss that you incurred.

If you have an eligible qualified new business or a small business and your NOL is greater than the amount of net loss from such a business, use the general NOL first. If you operate one or more new businesses and one or more eligible small businesses, determine the amount of the loss attributable to the new business(es), the small business(es), and the general NOL in the following manner. The NOL is first treated as a new business NOL to the extent of the loss from the new business. Any remaining NOL is then treated as an eligible small business NOL to the extent of the loss from the eligible small business. Any further remaining NOL is treated as an NOL under the general rules.

### Part II

Use Part II to limit current year disaster loss and NOL carryover deductions to current year income and to record all of the corporation's loss carryover information.

If the corporation has losses from more than one source and/or more than one category, the corporation must compute the allowable NOL carryover for **each** loss separately.

#### When to use an NOL carryover

Use your NOLs and disaster losses in the order the losses were incurred. There is no requirement to deduct NOL carryovers before disaster loss carryovers.

#### Prior Year NOLs

**Column (a)** – Enter the year the loss was incurred.

**Column (b)** – If the loss is due to a disaster, enter the disaster code from the list below. If the loss is from a new business or eligible small business, enter the SIC Code for the new business or eligible small business from the Standard Industrial Classification Manual. DO NOT enter the code from the PBA chart available in the 2004 Form 100, Form 100W, or Form 100S booklets. If the loss was from an S corporation, enter the entity's federal employer identification number from Schedule K-1 (100S).

List of events that have been declared disasters:

Year	Code	Event
2005	25	Southern California flooding, debris flows, and mudslides*
2004	24	San Joaquin Levee Break
2003	23	San Simeon earthquake
2003	22	Southern California fires and other related casualties
2000	21	Napa County earthquake
1999	20	Wildfires and other related casualties*
1999	19	Winter Freeze 98/99
1998	18	El Niño 98
1997	17	Disaster floods 96/97
1996	16	Firestorms 96*
1995	15	Storms, flooding, and other related casualties
1994	14	San Luis Obispo fire and other related casualties
1994	13	Los Angeles, Orange, and Ventura County earthquake and other related casualties
1993	12	Storms, floods, and other related casualties
1992	11	Wildfires and other related casualties in Calaveras and Shasta Counties
1992	10	San Bernardino County earthquake and other related casualties
1992	9	Riots, arson, and related casualties in California during April and May
1992	8	Humboldt County earthquake and related casualties
1992	7	Storms, floods, and other related casualties
1991	6	Oakland/Berkeley fire and other related casualties
1990	5	Santa Barbara fires and other related casualties
1989	4	Bay Area earthquake and other related casualties
1987	3	Forest fires, October earthquake, and other related casualties
1986	2	Storms, floods, and other related casualties
1985	1	Forest fires and related casualties occurring in California

\*Carryover period and percentage are limited to the NOL rules. No special legislation was enacted.

**Column (c)** – Enter the type of NOL from the table in General Information F, Types of NOLs. If using a Pierce's disease, or an EDA NOL, get the applicable form for the NOL type.

**Column (d)** – Enter 100% of the initial loss for the year given in column (a).

**Column (e)** – Enter the NOL carryover amount from the 2003 form FTB 3805Q, Part II, column (h).

**Column (f)** – Enter the smaller of the amount in column (e) or the amount in column (g) of the previous line.

**Column (g)** – Enter the result of subtracting column (f) from the balance in column (g) of the previous line.

**Column (h)** – Subtract the amount in column (f) from the amount in column (e) and enter the result.

#### Current Year NOLs

**Note:** If a disaster loss occurs between the date of the publication and the end of the taxable year, please go to our Website: [www.ftb.ca.gov](http://www.ftb.ca.gov) for an updated version of this form, which will include information for any subsequent disaster loss. Then follow the line 3 instructions.

#### Line 3 – Current year Disaster Loss

If you did not elect to deduct your current year disaster loss in the prior year:

- In column (d), enter your 2004 disaster loss from Part I, line 2.
- In column (f), enter the disaster loss used in 2004.
- In column (h), enter column (d) less column (f).

If you elected to deduct your 2004 disaster loss on your 2003 tax return, and you have an excess amount to be carried over to 2004, enter the carryover amount in Part II, line 2, column (e). Use the Prior Year NOL instructions for column (a) through column (h) except:

- In column (a), enter 2004;
- In column (b), enter the new disaster code; and
- In column (d), enter the total disaster loss incurred in 2004.